PREME COURT, U. S.

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NO. 661

In the

SUPREME COURT OF THE UNITED STATES

October Term, 1968

EDGAR I. SHOTT, JR.,

Petitioner,

vs.

THOMAS A. CONROY, Trustee in Bankruptcy for Leslie D. Stickler, Bankrupt,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above entitled case on June 21, 1968.

OPINION BELOW

No printed opinion was filed in this case. The Order of affirmance is reproduced in the Appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on June 21, 1968 and the order of

such court denying petition for rehearing was entered on July 19, 1968. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254 (1).

QUESTIONS PRESENTED

I. May a trustee in bankruptcy, in an action maintained solely by authority of 11 U.S.C. Sec. 110 e (1), (Section 70 e (1) of the Federal Bankruptcy Act), be permitted to recover fraudulent transfers made by the bankrupt, in the absence of proof that, at the time of each such transfer, there was in existence a creditor of the bankrupt having a claim provable against the bankrupt in the bankruptcy proceedings?

II. May a trustee in bankruptcy, in such an action, recover the cumulative total of 600 or more transactions, amounting to $1,354,910.00,thereby intentionally creating a monumental surplus in the bankrupt estate?

THE STATUTE INVOLVED

The pertinent statute is Title 11 U.S.C. Sec. 110 e (1) which provides:

> "A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

STATEMENT OF THE CASE

This is the second Petition for Writ of Certiorari filed by petitioner in this case. Originally the district court in Cincinnati granted respondent's motion for summary judgment and entered judgment against Shott for $1,363,410.00.

On appeal, the Court of Appeals for the Sixth Circuit held that the district judge was correct in granting summary judgment "on the legal issue of liability" but vacated the judgment and remanded in this language:

> "The record discloses 600 or more transactions between defendant and the bankrupt, which presumably involved many loans, credits and repayments. The record does not demonstrate to our satisfaction that the cumulative total of $1,363,410.00 is the correct basis for judgment.
>
> The judgment of the district court is vacated and the case is remanded for a redetermination of the amount of the judgment."
>
> 363 F. 2d. 90, 94

Shott's Petition for Writ of Certiorari (No. 546 October Term, 1965, denied December 5, 1966, 385 U.S. 969) questioned only the propriety of granting summary judgment in the circumstances disclosed.

The nature of the transaction which gave rise to the trustee's suit was described in the Sixth Circuit's opinion:

> "The bankrupt inaugurated a scheme wherein he would borrow a sum of money from A, then borrow from B to repay A, borrow from C to repay B and so on. The inducement was a high rate of interest on a short term. This is referred to as a 'Ponzi' type scheme. . . .
>
> Defendant-appellant, Edgar I. Shott, Jr., . . . was a lender to the bankrupt. . . . Millions of dollars were involved in the scheme and it appears that some 120 or more people made loans to the bankrupt in widely varying amounts, aggregating $3,309,462.05.
>
> "The trustee sued the defendant to recover a cumulative total of $1,343,410, (sic) representing some 600 transactions between the defendant and the bankrupt."
>
> 363 F. 2d. 90

"Cumulative total," of course, refers to the fact that, to a large extent, the same dollars were counted each time they changed hands in these 600 plus transactions.

The original pre-trial order limited summary judgment procedure to the "issue of liability" and plaintiff's motion was specifically so limited. Admittedly, none of the affidavits submitted by plaintiff in support of his motion for summary judgment contained the slightest reference to the existence of a creditor having the standing to attack any of these 600 some transactions. On remand, therefore, counsel expected that each of these 600 transactions would be tested by proof that a creditor having a provable claim in the Stickler bankruptcy was a creditor in existence at the time of the transaction and thus, in the absence of bankruptcy, would have had standing to successfully attack the transaction. Surprisingly, not a scintilla of evidence in this regard was offered on trial of the case. At the conclusion of plaintiff's case defendant, therefore, moved for a directed verdict. It was promptly overruled. (R. 64-65, App. 37a-38a)

The trial judge refused to permit defendant to offer the testimony of witnesses in support of the allegations contained in the Amended Answer. (R. 65-66, App. 38a-39a). Defendant, therefore, proffered into the record the following evidence:

> That the total claims filed in the Stickler bankruptcy approximate $400,000.00 of which $374,152.25 represent claims made by persons who participated in the bankrupt's fraudulent scheme. None of the filed claims have been allowed. In addition to the instant action, other actions were instituted by the trustee and are pending against seventeen other individuals, all alleging causes of action identical to those contained in this Amended Complaint, which actions seek recovery in the aggregate sum of $875,377.78. As of February 23, 1967, the trustee had on hand in

the bankrupt estate the sum of $52,036.50. (R. 66-67, App. 39a-40a).

The district judge who presided over the trial was under the impression that the case involved unlawful preferences.

> "Many of the matters that have been argued to this Court for defense will certainly not apply in any way to that four months period."
>
> (R. 15, App. 14a)

In explaining to the jury why he was directing them to return a verdict for the plaintiff in the total sum of $1,354,910.00 he stated:

> "Several questions of law were presented by the defendant. I allowed them to put it in the record so as to protect whatever rights they may have; I don't believe those defenses apply in this case. So I am going to do what we call a directed verdict for the plaintiff. . . ."
>
> (R. 73, App. 41a-42a)

The judge then directed the jury to return a verdict for $264,175 to cover the four months period immediately preceding bankruptcy and $1,090,735 for the period September 19, 1957 to September 18, 1960 for a total verdict of $1,354,910. (R. 74, App. 42a). The trial judge was obviously unaware that plaintiff's causes of action, other than that authorized by 11 U.S.C. Sec. 110 e (1), had been held barred by the two year statute of limitations of 11 U.S.C. Sec. 29 (e). Being totally unaware that he was trying a case authorized solely by Sec. 110 e (1), it's no wonder the judge did not attach significance to the "defenses" inherent in that statute.

On appeal, the Court of Appeals for the Sixth Circuit affirmed, holding that "in the former appeal . . . this

Court decided all issues of liability against appellant . . . . The trustee offered evidence to the effect that appellant received from the bankrupt the sum of $1,354,910 during the period between September 17, 1957, and January 4, 1961. Neither the trustee nor appellant offered any evidence as to loans, credits or repayments." When the Court of Appeals failed to deal with the evidential vacuum as to the existence of a creditor having the standing to attack any of these transactions spanning a three year period, Shott filed a Petition for Rehearing. That Petition was denied, without explanation, on July 19, 1968.

REASONS FOR ALLOWING THE WRIT

I.

In effect, the Court of Appeals has rendered a decision in stark conflict with decisions rendered in both the Fifth and Tenth Circuits, in conflict with the position stated by this Court and in conflict with respected text writers. To permit the trustee to recover the sum total of 600 transfers, which took place over a period in excess of three years, without requiring proof that a creditor represented by the trustee was harmed by such a transfer, is to ignore decisions directly to the contrary in *Coleman* v. *Alcock*, 272 F. 2d. 618 (C.A. 5, 1959) and *Midland Supply Co.* v. *Amer. Drilling Co.*, 302 F. 2d. 128 (C.A. 10, 1962). And although it may be said to be dictum, Mr. Justice Douglas, writing for a unanimous Court in *Lewis* v. *Manufacturers Nat. Bank*, 364 U.S. 603, 608-609 (1961) said:

> "Section 70e enables the trustee to set aside fraudulent transfers which creditors having provable claims could void. The construction of Sec. 70c which petitioner urges would give the trustee power to set

> aside transactions which no creditor could void and which injured no creditor. That construction would enrich unsecured creditors at the expense of secured creditors, creating a windfall merely by reason of the happenstance of bankruptcy."

In the court below Respondent conceded this evidential deficiency but argued that since the bankrupt was admittedly insolvent — "How can there be insolvency without creditors?" But the fact that there *were* creditors in the past is of no moment.

> "In all cases, the trustee proceeding under Sec. 70 (e) must allege and prove that he is asserting the right of some creditor who holds a *provable claim* against the bankrupt and who would have been entitled to avoid the transfer had not bankruptcy intervened."
>
> 4 *Collier on Bankruptcy,* 14th Ed. Paragraph 70.94 p. 1775

As stated in *Rockmore* v. *Schilling,* 72 F. Supp. 172, 175 (U.S.D.C. New Jersey, 1947):

> "It is manifest that if the creditor has been paid off on the claim as it stood at the time of transfer, he may not complain at a future date that he has been injured by the prior transfer."

II.

In approving the intentional creation of a monumental surplus in the bankrupt estate, the decision of the Court of Appeals is in conflict with the philosophy of this Court as expressed in *Page* v. *Rogers,* 211 U.S. 575 (1909). The evidence proffered into the record by defendant established that of the filed claims in the bankruptcy proceedings, which total approximately $400,000.00, $374,152.25 represent claims by those who were participants in the fraudu-

lent scheme. It is significant that although the Stickler bankruptcy proceedings commenced in January, 1961, not one claim has yet been allowed. It seems apparent that the Referee will ultimately disallow those claims filed by participants in the scheme. For example, one such claimant, Richard F. Brower, has filed a claim for $187,750.00. On September 9, 1968 the respondent herein recovered a judgment against Brower for $273,270.00 in one of the seventeen companion cases. Can it seriously be doubted that Brower's claim, and the others like it, will be disallowed. It is well established that bankruptcy courts, in passing on claims, sits as a court of equity and claims may properly be disallowed on equitable grounds. *Pepper* v. *Litton,* 308 U.S. 295 (1939). Assuming the disallowance of the tainted claims, those remaining, if fully allowed, amount to only $26,000.00. The evidence proffered at trial was that the trustee, as of February 23, 1967, had on hand in the bankrupt estate, the sum of $52,036.50. (In a recent newspaper article the trustee reported to now have $85,809.-00 on hand and is quoted as reporting two new settlements totalling an additional $54,643.00.) Obviously, the trustee now has more than adequate funds to pay all legitimate claims plus fees and expenses.

At the time of trial, the trustee had on hand more than twice the amount needed to pay all legitimate claims. Why, then, should he be permitted to attack all 600 separate transactions of Shott with the bankrupt in order to intentionally create a huge surplus? In the court below, the trustee claimed that he was *required* to do so by *Moore* v. *Bay,* 284 U.S. 4 (1931). That case merely holds that if a transfer or obligation is voidable at all, it is voidable in toto, without regard to the amount of the creditor's claim. Thus, in the instant case, if we were dealing with but one transaction in the amount of $1,354,910.00, the

amount of the judgment entered below would be correct. But we are dealing with more than 600 separate transactions which occurred over a period exceeding three years. Assume that at the time of trial the trustee had no assets in the bankrupt estate. Why should he be allowed to set aside transactions, admittedly valid between the parties, to produce more funds than necessary to pay all legitimate claims and expenses?

This Court has held that when the trustee sues in a *state* court, the defendant may not litigate the question of the validity of the claims against the bankrupt, for, to permit it: "would transfer the administration of a bankrupt's estate from the United States District Court to the state court." *Eau Claire National Bank* v. *Jackson,* 204 U.S. 522, 538 (1907). Where, as here, the proceedings are had in the bankruptcy court itself, a different rule prevails. In *Page* v. *Rogers,* 211 U.S. 575 (1909) this Court commented favorably on the decree entered by the court below in these words:

> "The theory upon which the decree proceeded was, that no greater sum should be required of the defendant than would be needed to meet the amount of the claims proved or provable against the bankrupt and the cost and expenses of the administration of the bankrupt estate. including fees of counsel for the trustee. . . ."
>
> (580)

> "In view of the fact that this suit was brought in the bankruptcy court itself, and a final decree is to be entered by a judge of that court, it is entirely practicable to avoid the circuitous proceeding of compelling the defendant to pay into the bankruptcy court the full amount of the preference which he has received, and then to resort to the same court to obtain part of it back by way of dividend."
>
> (581)

The fundamental fairness of such a doctrine is apparent. For example, in *Pennington* v. *Leff,* 183 F. Supp. 884 (1960), the Trustee brought suit to recover $63,620.50 in voidable preferences. The court granted judgment for only $9,440.29 stating:

> "The benefits of the bankruptcy statutes inure to debtor and creditors, and to the trustee only as he represents the interests of both. No useful purpose would be served in compelling these defendants to pay into the bankrupt estate an amount far in excess of the filed claims and also in excess of the amount which, if paid, would have prevented any necessity of bankruptcy. It is not the purpose of bankruptcy proceedings to punish, but to see that substantial justice is granted to all creditors."
>
> p. 890

In the court below, counsel for the trustee sought to justify the intentional creation of a huge surplus by relying on Section 57 (n) of the Bankruptcy Act (11 U.S.C. Sec. 93 (n)). While that section provides some method for dealing with a surplus which might occur, it is no authority for the proposition that a surplus should be created. As applied to Shott, it provides that if he first pays the entire judgment of $1,354,910.00, he may then participate to some extent in the surplus thus created. From a practical standpoint, therefore, Shott would be rendered bankrupt, and, at the same time, precluded from participating in the surplus he helped create.

In the last analysis, it was the duty of the trustee and his counsel to try to realize sufficient assets to pay approximately $26,000.00 in bona fide claims. On March 20, 1963, when the original complaint was filed by the trustee against Shott, it alleged that the trustee then had on hand the sum of $23,000.00. Yet the prayer was for $1,363,410.00! When the case came to trial the trustee had on

hand more than double the amount needed to pay all legitimate claims in full. Yet a judgment was entered for $1,354,910.00. It now appears that the trustee has in his fund, or secured to be paid, the sum of $140,452.00. It is submitted that when this needlessly created pie is finally cut up, the results will shock this Court and the public conscience as well.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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Counsel for Petitioner

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Cincinnati, Ohio 45202

APPENDIX

No. 17,966

In The
UNITED STATES COURT OF APPEALS
for the Sixth Circuit

THOMAS A. CONROY, Trustee in Bankruptcy
for LESLIE D. STICKLER, Bankrupt,
Plaintiff-Appellee,

v.

EDGAR I. SHOTT, JR.,
Defendant-Appellant.

(Filed June 21, 1968)

ORDER

Before WEICK, Chief Judge, EDWARDS and PHILLIPS, Circuit Judges.

This is the second appeal in this case from the United States District Court for the Southern District of Ohio. In the opinion in the former appeal, reported at 363 F.2d 90, cert. denied, 385 U.S. 969, this Court decided all issues of liability against appellant and in favor of the trustee in bankruptcy. The case was remanded to the District Court for a redetermination of the amount of the judgment by the following language:

> "The record discloses 600 or more transactions between defendant and the bankrupt, which presumably involved many loans, credits and repayments. The record does not demonstrate to our satisfaction that the cumulative total of $1,363,410 is the correct basis for judgment.
>
> "The judgment of the district court is vacated and the case is remanded for a redetermination of the amount of the judgment." 363 F.2d at 94.

After the announcement of the decision of this Court, a jury trial was held to determine the amount of appellant's liability. The trustee offered evidence to the effect that appellant received from the bankrupt the sum of $1,354,910 during the period between September 17, 1957, and January 4, 1961. Neither the trustee nor appellant offered any evidence as to loans, credits or repayments. The District Judge thereupon directed a verdict in favor of the trustee in the amount of $1,354,910.

Since appellant failed to offer proof as to credits or payments, if any, to which he may be entitled, we hold that the District Judge did not err in directing a verdict.

It is ORDERED that the judgment of the District Court be and hereby is affirmed.

Entered by order of the Court.

/s/ CARL W. REUSS
CLERK

Issued as Mandate: August 14, 1968
COSTS: NONE

A True Copy.

ATTEST:
Carl W. Reuss, Clerk

By /s/ GRACE KELLER
Chief Deputy

A True Copy of the Original Filed August 15, 1968.

Attest: JOHN D. LYTER, Clerk

By /s/ SUZANNE D. McGONEGLE Deputy

Certified August 15, 1968.